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SPECIAL PROBLEMS FACING SMALL BUSINESS IN THE MIDWEST

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENTREPRENEURSHIP AND SPECIAL PROBLEMS
FACING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

SPECIAL PROBLEMS FACING SMALL BUSINESS IN THE MIDWEST

EAU CLAIRE, WIS.—AUGUST 22, 1983

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SPECIAL PROBLEMS FACING SMALL BUSINESS IN THE MIDWEST

MONDAY, AUGUST 22, 1983

U.S. SENATE,
SUBCOMMITTEE ON ENTREPRENEURSHIP AND
SPECIAL PROBLEMS FACING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Eau Claire, Wis.

The subcommittee met, pursuant to notice, at 10:10 a.m., in the board room of the Eau Claire County Courthouse, Hon. Bob Kasten, presiding.

Present: Senator Kasten.

Staff present: Louis Luna, legislative assistant to Senator Kasten, and Michael Morris, counsel.

STATEMENT OF HON. BOB KASTEN, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. This hearing of the Subcommittee on Entrepreneurship and Special Problems Facing Small Business will come to order.

First of all, thank you for joining us this morning. I greatly appreciate your being here.

Today we are going to be looking at the problems facing small business in the Midwest, in an effort to get an idea of the scope of the problems which face the region and, also, to try to devise solutions to these problems.

This hearing is the first of a number of hearings that we are going to be having in other parts of Wisconsin and possibly in other parts of the Midwest as we look, through this subcommittee, at special problems facing small business.

We have several individuals here today whom I would like to introduce to you.

First of all, we are honored to have with us Mr. Eddie Herrera, the Deputy Administrator of the U.S. Small Business Administration. Mr. Herrera was kind enough to come out from Washington to join us. He accompanied me earlier this morning on a tour of a couple of key small businesses in the area.

Prior to joining the SBA, he served in the Navy, earned an MBA from Harvard, worked in the private sector on real estate and community development projects, and has a wealth of experience which relates directly to small business.

We welcome you to the subcommittee and welcome you to Eau Claire. At the conclusion of my remarks, I hope that you will share some of your thoughts with us.

Accompanying Mr. Herrera is Mr. Curt Charter, who is the District Director for the SBA. He is headquartered in Madison. He has been a District Director for over 3 years.

Also with us is Mr. Louis Luna, who is my legislative assistant for small business affairs, and Mr. Michael Morris, who is a staff member with the Senate Small Business Committee.

The Wisconsin business community has expressed a great deal of interest in this hearing, and I find that gratifying. It would be impossible for us to hear from everyone who has an interest in the state of small business, so out of necessity we have had to limit the number of people who can testify here today. We still need your advice, though, so written testimony will be received by the subcommittee. The record will remain open for the next 2 weeks, and testimony that is received in writing by the subcommittee during that time will be made a part of the permanent record of these hearings.

Before proceeding with testimony, I would like to take just a moment to explain why we are here today and what I hope that we can accomplish through these hearings.

This hearing is being held in Eau Claire, Wis., and not in Washington, D.C., for several reasons.

First, I believe in the wisdom and the commonsense of the people. Solutions to the problems of this region are best found not in Washington, but rather right here among the people, the small businessmen and small businesswomen, who live and work with the situation every single day.

Second, I believe we in the Midwest have borne the brunt of the recent recession. This hearing is designed to look at business conditions and to identify solutions to the problems that are faced by Midwestern firms. It is our hope that whatever works here to improve the business climate and encourage small business will work in other areas of the country that have had similar, but normally less severe, business problems.

Third, Eau Claire is the heart of an area that is in many ways representative of the Midwest. It is an area with a strong small business tradition and with an active business community interested in promoting small business growth. Its an area that I believe has a strong business track record and an understanding of the importance of small business. We have around here a number of very, very successful small businesses. The business leaders of this community are anxious to share their experiences and advice with others. I am, therefore, glad to have the benefit of the views of the business people in this particular area.

We are now seeing the beginnings of a long-awaited economic recovery, a consumer-led recovery, but it is important that we not kid ourselves. Times are still tough, and they are especially tough for small businesses. Interest rates are high. The real rate of interest, which is the difference between the rate of inflation and the prime interest rate still represents too big a gap. Taxes still punish success and indirectly reward failure. Firms are going under due to stiff competition at home and abroad. This last point was brought

home to me this morning during a visit to Phoenix Steel, where we reviewed some of the problems posed by British and Japanese steel imports.

Equally important, I believe, we want to make sure that recovery spreads to all parts of the country. That might be difficult. I don't have to tell you that other States, and other regions of the country, are in the process of trying to lure both small and larger businesses away from Wisconsin and into their areas. They are providing tax breaks and other incentives for businesses to locate or expand there. It is obvious that unprofitable or undesirable business conditions will drive firms away from any area, including our own.

Although this hearing relates to Federal small business issues, we must also understand the relationship other environmental factors have on small business development.

When we identify a small business problem, we in government should use a commonsense approach to solve it. We must make sure that businesses, particularly small ones, have a climate in which to grow. The approach, I believe, is a simple one. If it is unprofitable to do business in a particular area, then we need to make it profitable for firms to do business in that area.

What would make it unprofitable? Do taxes take too big a bite out of profits? Then cut the tax rate. The revenues we will receive from the increased volume of business will more than make up for the tax cut, and that has been demonstrated with the tax cuts at the Federal level over the past 2 years.

Are interest rates too high? Well, massive Government deficits lead to heavy Government borrowing, which drives up interest rates. Let's cut the rate of growth of Government spending, because the answer to our economic problems lies in the private sector, not the public one. Our leaders at all levels need to open their arms to the influx and growth of small business. When we do that, we will then see economic growth of the kind that Government spending alone could generate.

These are the kinds of general themes which I want to touch on.

Once again, I am pleased to have the opportunity to chair this hearing of our subcommittee, and at this point I would like to introduce the Deputy Director of the U.S. Small Business Administration, Mr. Eddie Herrera, for any comments that he may have.

STATEMENT OF EDDIE HERRERA, DEPUTY ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Mr. HERRERA. Thank you so much.

I am pleased to be here in Eau Claire, Wis., with the Senator to look at those issues that are important to the small business community in this area.

I find in Washington, D.C.—I have been there a short while, about 10 months—I find that Washington, D.C., is a very unique place. As soon as you cross the Potomac it is almost like going into a land of fantasy. You need to get out in the field to find out what is really happening to impact on some of the programs and procedures that we have that are really not doing the best for the small business community.

Where I can help is not really in the delivery of the service, but in trying to improve that service for you, through policy changes, directives to the field as to what can be done to cut down the red-tape and to cut down on paperwork, to be more responsive to you, the small business community, especially in enforcing what we believe is the role of Government, and that is to support you and to provide you with opportunities—not to guarantee success for you, not to interfere with your business, but to provide that environment that the Senator mentioned that can best create a good business environment for you.

I am pleased to be here to listen to what you have to say. In particular, I would like to hear specific recommendations on the programs that you folks have worked with, where we might be able to make some changes and improve the service to you.

Thank you.

Senator KASTEN. Thank you, Eddie.

Our first witness today is Mr. Bill Smith, who is the director of governmental relations for the Wisconsin office of the National Federation of Independent Business. He is headquartered in Madison, but, as I would assume a number of you know, he was born and raised right near here. He has, in a way, kind of come back home. We both came in on the same plane last night, and he had a whole gang greeting him. I assume part of those were friends and family.

Bill has worked for NFIB for the past 5 years.

It is good to have you here, Bill, and thank you for joining us.

Please proceed with your statement.

STATEMENT OF BILL G. SMITH, WISCONSIN DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, MADISON, WIS.

Mr. SMITH. Thank you, Senator Kasten and Mr. Herrera. I very much appreciate this opportunity to appear before your subcommittee on behalf of the NFIB, and especially on behalf of our 13,000 members in the State of Wisconsin.

Government officials, particularly elected officials, are becoming increasingly aware of the important contribution of small business to the economic health of our State and our Nation. This is not to say that big business is any less important. Those of us who represent small business are not anti-big-business. Should any large business or industry move out of our State, the small business community would be profoundly affected. The failure of large industrial sector to grow and prosper has surely a most negative impact on small business.

Nevertheless, it is important that policymakers be made aware of the vital role played by small business in our economic recovery and future prosperity. In the past most of the economic development policies of State government have tended to center on industrial recruitment of large employer firms, often to the neglect of small, in-State employers who in the aggregate provide the majority of the jobs and most of the new job creation.

While Governors do not often participate in ribbon-cutting ceremonies to open up new small business, we must recognize that small business is, indeed, the backbone of any State's economy. Re-

gardless of the magnitude of the industrial recruitment and concomitant job location aspects of such policy, no State's economy can thrive without a business climate that is conducive to the small entrepreneur.

The numbers alone in terms of number of business firms, employers, and employees, simply dictate the dominant force of the State's economy must be small business.

Between 1979 and 1980, while manufacturing firms lost 727,000 jobs, small establishments of less than 20 employees gained 53,000 jobs during that period. Small businesses not only laid off fewer people during the recession, but actually experienced employment gains in several business sectors dominated by small firms.

As policymakers and planners of future economic strategy, it is important for you to know and to understand that the bulk of the jobs, the real numbers which will truly put our citizens back to work and keep them working, which is the real key to economic revitalization, will come from small business dominated industries.

According to data provided by the Office of Economic Research of the SBA, in 1980 there were more than 76,000 independently owned enterprises in Wisconsin, and they employed about 1.4 million workers. Ninety-nine percent of these enterprises had fewer than 100 employees and about 56 percent employed between 1 and 4 workers.

It is necessary for you as public officials to do everything you can to cultivate and to nurture an economic climate that will allow for easy formation and growth of our small business sector.

Recently, the NFIB Research and Education Foundation released the results of a study entitled, "Small Business Problems and Priorities." Our members were asked to rate the severity of each of 72 possible small business problems. I would like to share with you very briefly the results of that study.

Interest rates, perhaps it is no surprise, were judged by small business owners as the most severe of the 72 possible small business problems presented for their evaluation. Over 26 percent of all respondents termed interest rates a critical problem, the strongest or the most extreme rating that could be given.

While interest rates are timebound in the sense that posing the same questions 6 months earlier or 6 months later might substantially affect the results, it is clear that during the late autumn of 1982 small business owners were substantially more concerned over the cost of money than they were over any other problem.

Given the prime rate at the time of the study, the results were predictable, but those possible problems which constituted the remainder of the top 10 were not. Interest rates were followed in order by the cost of liability insurance; the cost of natural gas, gasoline and fuel oil; telephone rates; cash flow; the cost of property and casualty insurance; electricity rates; payroll taxes; poor earnings; and projected future sales changes.

The curious point about those problems falling within the first 10 is the dominance of what one might term "regulated costs." Four, and possibly five, of the top 10 problems are costs effectively regulated by some governmental body, and generally an entity of the State. In fact, if all 72 problem areas are divided into broad problem or issue areas, the regulated cost issue area clearly was evalu-

ated by small business owners as the most serious source of problems.

In terms of creating an atmosphere which will promote small business growth and prosperity, we can define the Government's role as simply being aware of the importance of small business in our overall economy and responding to the problems identified by the small business community itself.

Clearly, there is a problem with small business access to capital, over-regulation of the small business sector, the burdensome payroll taxes, the high cost of utilities.

The last session of the Wisconsin legislature began to recognize that there are, indeed, unique problems associated with owning and operating a small business in this State.

The Paperwork Reduction Act, the inheritance tax exemption for interspousal transfers, deregulation of intrastate trucking, reduced capital gains tax rates, indexed tax rates, were all very positive laws enacted for which the small business community is grateful.

The NFIB of Wisconsin is asking our legislators in Madison to simplify and reduce the regulation of small business by adopting a tiered system of regulation, as in Minnesota, Illinois, and a system which is modeled after the Federal Regulatory Flexibility Act approved by Congress and signed into law in 1981.

We applaud the efforts of Eau Claire Representative Mark Lewis, who has introduced legislation in this session which would provide small businesses greater access to capital at affordable rates.

We believe Wisconsin truly took a step backward in tax fairness when the progressive corporate income tax rate structure was scrapped in favor of one flat rate, a rate which at 7.9 percent, without the 10 percent surtax, is the ninth highest among the 29 States that have a flat corporate tax rate.

It is time Wisconsin followed the lead of dozens of other States such as Illinois and Iowa in adopting equal access to the courts bills, so that small business is no longer denied access to our judicial system.

The NFIB of Wisconsin is working hard for passage of legislation to fulfill the No. 1 recommendation of the Governors Conference on Small Business, unemployment compensation reform. It is vitally important that we get the UC funding monkey off the back of small, stable employers and that some equity be restored among those employers who must fund a system, a system which provides the sixth highest benefit level of any system in the Nation.

Lawmakers can improve our business climate by passing legislation to further reduce the inheritance tax burden on not only our family-owned and operated businesses, but on our family farms as well, a tax burden ranked by the U.S. Department of Commerce as 34 percent above the national average.

Legislation is needed to remove bureaucratic barriers, so that small business may participate in fulfilling the procurement needs of our State.

In many of these issue areas Government at the Federal level has led the way, and we commend you for your efforts and hope that Government at the State level will share your vision by responding to the needs of small business here in Wisconsin with similar initiatives.

To conclude, it is our hope—indeed, it is our goal—that lawmakers will come to truly appreciate the tremendous contribution provided by our small business community to the economic health of our State. With this recognition, our small businesses will be afforded the kind of consideration which will enhance their role in the economic strategy needed to lead Wisconsin out of the recession.

Thank you very much.

Senator KASTEN. Bill, thank you.

Before I go on with a couple of quick questions, I want to thank you for your mention of the liability insurance problem. As you know, and as other people in the room probably know, I am the author of S. 44, the Product Liability Act. I think it is a key small business issue. I have been noting, in my discussions with Mike McKevitt of NFIB and others in Washington, the increasing importance that the small business community places on this issue.

I think legislation to reform product liability laws, and thereby reduce the liability costs for businessmen, is important not just for small business but also for consumers.

As you may know, we have a system right now in which, for every 66 cents that goes to an injured party through some kind of small business claim, 77 cents goes to lawyers. The system is so gummed up with differing interpretations of product liability laws that it is just not efficient. I hope that, working with NFIB and other groups such as IBAW, we can make some progress on this issue.

You said, and I quote, "No State's economy can thrive without a business climate that is conducive to the small entrepreneur."

If a State argues, as I think Wisconsin does right now, that it cannot afford to cut taxes, and if many business costs are regulated, as you say, by State agencies that are independent of any particular administration, what specific things can States do to create a better business climate? What are the specific things other than cutting taxes that you are working for now?

Mr. SMITH. I think the emphasis is on the regulatory aspect of it. By tiering, for example, the regulatory flexibility bill that will soon be introduced in the legislature, with strong bipartisan support, by reducing the regulatory burden on the small business sector, you are saving considerable operating costs out there. Regulation is a cost factor in operating that business. If we can lessen a reporting requirement, lessen that regulatory burden just ever so slightly, it saves that small business person considerable time and money.

I think that the legislature has responded in a positive way, also, with the Paperwork Reduction Act that was enacted by the legislature last session. Hopefully, that will save money both inside and outside of Government by making the flow of paperwork more efficient, by consolidating various forms, and as far as the small business person is concerned, that they will have fewer forms to fill out and less complicated ones.

Senator KASTEN. At the Federal level, you know that OSHA is one of the worst offenders in making small businesses fill out forms. Lately, though, we have been applying thresholds, saying that certain regulatory requirements do not apply for firms with small numbers of employees.

Have you noticed a difference, since those thresholds took effect, in the number of forms you and your members have had to fill out? In other words, are we moving in the right direction?

Mr. SMITH. I think it is the key. We are seeing in a very limited sense a change in the emphasis. We used to hear that it is a Federal problem, a Federal paperwork problem. That was where our paperwork problem was. I think we are seeing somewhat of a shift in that and starting to direct a little bit more of their attention to the State level.

Senator KASTEN. Eddie, do you have any questions or comments?

Mr. HERRERA. Just a comment, Senator.

Mr. Smith, I just want to thank you, the NFIB, for a long-time and a very close working association with the Small Business Administration. I certainly appreciate your comments. They seem to be more directed at the State level environment rather than the Federal, but we continue to work with your organization. We certainly appreciate your testimony today.

Mr. SMITH. Thank you very much for the opportunity.

Senator KASTEN. Thank you very much.

Our next witness is Mr. Sam Hope III. He is a Milwaukee native and works with the Griffith-Hope Co. of West Allis, Wis., a metal stamping firm. He is the Independent Business Association of Wisconsin's vice president for Federal programs.

Thank you for coming here today and participating in this hearing.

STATEMENT OF SAMUEL N. HOPE III, VICE PRESIDENT FOR FEDERAL PROGRAMS, INDEPENDENT BUSINESS ASSOCIATION OF WISCONSIN, WEST ALLIS, WIS.

Mr. HOPE. Thank you, Senator.

As you said, I am representing both the Independent Business Association of Wisconsin as vice president of Federal programs and Small Business United, a national organization of small business groups where I serve as vice president. We appreciate the opportunity to appear before the subcommittee on special business problems of the Senate Small Business Committee.

Small business, especially in the Midwest, faces great challenges over the next few years. Of primary concern to entrepreneurs is the size of the Federal deficit and its effect on capital markets and interest rates. "Crowding-out" is not an abstract economic theory; it is an every-day problem for those of us whose primary source of capital is a commercial bank. With large Federal deficits likely for the foreseeable future, IBA and SBU have developed a number of proposals to provide small firms increased access to capital markets.

Of prime importance is the vehicle known as the Small Business Participating Debenture. An SBPD is a hybrid security issued by a qualifying small business that:

Becomes a general obligation of the company;

Bears a stated rate of interest;

Has a fixed maturity date;

Grants no voting or conversion rights in the company;

Provides for the payment to the investor of a share of the company's total earnings, which would be taxed at capital gains rates;

Provides an ordinary deduction to the company of both the interest and share of earnings; and,

Allows for an ordinary deduction to the investor for losses he may suffer.

The specified terms of the SBPD, such as the interest rate, maturity date, and share of the earnings, would be negotiated at arm's length between the company and the investor with no Government involvement.

An SBPD could only be issued by a domestic trade or business, regardless of whether it is incorporated, which has a net equity of less than $10 million. Only companies that do not have outstanding securities that are subject to SEC regulation would be eligible to use SBPD's. Additionally, no company may have issued and outstanding at one time Small Business Participating Debentures with a face value in excess of $1 million.

The investor will find that new or expanding businesses will become one of the best places for his money, rather than one of the worst. He will have the benefit of realizing the appreciation of his investment at capital gains rates without having to dispose of it. The potential gain on successful investment would certainly warrant that risk. He will have an investment with a security yield potential of a note with the upside potential of the tax attributes of stock.

For the entrepreneur, SBPD's will make desperately needed funds available for product development, market development, and physical expansion. The typical small businessman will not mind generously sharing his profit as long as he knows that he is in control of his company and that there is a predetermined method for him to pay off his "partner" when his business can obtain conventional financing.

Various forms of the SBPD have been proposed in both Houses of Congress. SBPD legislation has very little opposition, but it has been hurt because Senators and Representatives have not given sufficient priority to its adoption, apparently because it is not as yet widely known. This is an idea whose time has come. We hope that SBPD's will be implemented in this Congress.

Next in the area of capital formation, industrial revenue bonds are of great importance to small business. We hope that the members of the Senate Small Business Committee will support initiatives designed to retain IRB's and their usefulness to small business.

Few capital formation issues deserve more support from Congress than the preservation of Industrial Revenue Bonds, tax-exempt instruments issued by State and local governments as a means of providing low interest loans to private ventures for industrial development.

Described by Chairman Weicker as "our best hope for promoting local economic development through Federal incentives," IRB's are a classic example of the new federalism in practice: They allow local communities to make their own decisions over their future economic development.

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Criticism of the bond program has arisen in the past due mainly to a relatively few abuses by several States which finance non-essential projects such as massage parlors and country clubs. This has resulted in overstatements of lost revenue to the Treasury.

This gave opponents of IRB's an opportunity to propose restrictions that would eliminate the program, but in 1982, as part of the Tax Equity and Fiscal Responsibility Act, Congress chose to reform, not destroy, IRB's.

By excluding certain facilities and opening up the bond process to the sunlight of public accountability, these new reforms will eliminate many of the controversial projects.

Some of these reforms actually improve on IRB's. Research and development expenditures are now exempt from the $10 million IRB capital expenditure limitation.

Second, Congress wisely lifted an unfair IRS ruling that prohibited IRB pools for small business.

There is little doubt that with serious deficits facing the Federal Government at this time another attempt will be made in Congress this year to severely restrict or eliminate IRB's.

Small Business United believes that as the economy recovers it is the time to maintain and improve Industrial Revenue Bonds, not eliminate them.

Finally, in the area of capital formation is the issue of capital gains reform. Senators Chafee and Bentsen have introduced Senate bill 1666, which would reduce the capital gains rate to a maximum of 10 percent on those issues which are, first, over 5 years and, second, where the issuing corporation would receive the proceeds.

We urge the members of the Senate Small Business Committee to join Senators Chafee and Bentsen as cosponsors of S. 1666, which would be an effective capital formation tool and improvement to the venture capital industry.

The next most important area for small business is that of new market opportunities. Unfortunately, new market opportunities are often made unattractive by confusing legislation and regulation. Nowhere is this more obvious than in the area of product liability, where manufacturers, distributors, retailers, and consumers alike face varying State laws. SBU has joined with Senator Kasten in supporting S. 44, which is designed to introduce uncertainty to the marketplace. We commend you for your fine work in this area and are proud that we have been helpful in arranging for a number of cosponsors.

A major new market opportunity for small business is the country's largest purchaser, the Federal Government. For years it has been the stated policy of the Government, through OMB Circular A-76, to procure all items possible from the private sector. This mandate, however, has been largely ignored through the years. Now Senator Rudman has introduced S. 1746, which would seek to codify many of the provisions of OMS Circular A-76. We urge Senator Kasten and other members of the committee to join with their colleague, Senator Rudman, in cosponsoring S. 1746. This bill would make it law, rather than executive policy, that the Federal Government seek to rely on the private sector for all procurement which is not affected by national security.

As the Midwest struggles to come out of the recession, new markets are of prime importance, and capital formation is what is going to drive businesses' participation in those new markets.

We thank you for the opportunity to testify today. I will look forward to working with Senator Kasten and other members of the Small Business Committee on issues affecting small business in the future.

Senator KASTEN. Sam, thank you. I would like to thank you, and IBAW, and Small Business United for your help on product liability.

Let me point out something about product liability for a moment. You made the point that ideally we want to have Government at the level closest to the people, and at one time we hoped that we could have the product liability question addressed State by State. In fact, the U.S. Commerce Department issued suggested guidelines for State product liability laws. Theoretically, each State should have adopted those laws, the way many have with the Uniform Commercial Code.

What happened, though, was that in the late 1970's and early 1980's some States rejected any kind of product liability law. The 28 or 29 States that did adopt such laws enacted laws that differed from each other. What we therefore have right now is a patchwork of product liability laws. If you are a crane operator in Illinois and back your crane into a power line, the crane manufacturer is held liable. The State law reasons he should have manufactured a safer crane, one that would have prevented you from backing into a power line or at least notified you of the danger. But if you do exactly the same thing in New Mexico, the law says you should know the obvious danger of touching a live wire with a metal crane, and the crane manufacturer is not held responsible for your negligence. This is an example of the crazy product liability system we have today.

I really appreciate your support, and that of the small business community, for product liability reform.

Let me go on to the other issues you raised.

You mentioned Industrial Revenue Bonds. As you may recall, the Senate attached an amendment to my withholding repeal measure to extend the IRB program.

Unfortunately, although the amendment was adopted by the Senate and advocated very strongly by Senator Roth, who was the author of the IRB extension bill, it was not accepted in the end by a House-Senate conference committee.

I think it is critical that we have a vigorous IRB program. We were at a plant this morning that depends upon Industrial Revenue Bonds, and we saw the impact of the IRB program.

Do you have specific examples of the effect of Industrial Revenue Bonds on small business?

Mr. HOPE. Senator, I think you just made a point, one of your plant tours this morning.

I know of one manufacturer in Milwaukee who is now working on his ninth industrial revenue bond. Without that kind of a program available to him, there is no way he could have financed the expansion of his business.

The abuses of the program largely involve such items as massage parlors and that sort of thing. Clearly, that is not what the program was designed for. Yet, those abuses have attracted headlines and they have attracted some very powerful opponents on Capitol Hill.

IRB's have been critical in helping small businesses grow and helping them keep their capital costs down. They are not only good for business, they are good for communities and good for jobs.

Senator KASTEN. Have you, either through IBAW or Small Business United, taken a position on the use of industrial revenue bonds for franchises? One of the questions that comes up is whether we should be using IRB's for McDonalds and those kinds of firms.

I do not want to prejudice your answer, but I happen to believe that, for example, McDonalds is employing a large number of people who desperately need to get back to work: Youth and minorities. Despite the fact that one can argue against letting these franchises develop using industrial revenue bonds, I happen to think it is all right.

Some of course, would mention abuses in the program, such as their use for massage parlors and the like, but I think these are exceptions to the rule and not in the same category as legitimate franchises.

Do you take any position on this issue?

Mr. HOPE. Senator, we tend to agree with you that not only are they employing people who often find it impossible to get jobs elsewhere, but although McDonalds is a giant corporation, many of its franchisees are very small businesses. It is purely a small business program.

Senator KASTEN. I noted your support for a bill to cut capital gains taxes for those who invest in firms for 5 years or longer. What kind of businesses do you think would benefit most from that kind of an arrangement? Are there changes that we could make in other tax rates that would have as great an impact on capital formation as this one would?

Mr. HOPE. The particular bill which Senators Chafee and Bentsen are sponsoring, although it does not say so specifically, it is primarily designed for startup businesses. The attraction of it is that if I were to buy a share of stock in a United States Steel or General Motors and hold it for 5 years, that would not be eligible for the program because, assuming I bought that share on a stock exchange, the issuing corporation is getting none of the proceeds. The only place where I would be eligible for that type of program is where the issuing corporation is getting the proceeds.

It seems to me that almost all of your eligible corporations are going to be startups or businesses that are expanding, and they need the sort of capital investment for market expansion, plant expansion for their markets.

I would think that as we are trying to retool America that this would be a great boon. After the 1978 capital gains reform, which Mr. Steiger pushed through Congress, we saw a dramatic increase in the investment activity in America, and there is no reason not to assume that this would have an equal effect.

Senator KASTEN. Eddie, do you have any questions or comments for Mr. Hope?

Mr. HERRERA. No, sir.

Senator KASTEN. Sam, thank you very much.

Mr. HOPE. Thank you, Mr. Herrera and Senator Kasten.

Senator KASTEN. Our next witness is Mr. Owen Ayres, a native of Eau Claire.

In 1959 he founded Ayres and Associates, which is an architectural and engineering firm. He served as Secretary of Transportation in the Dreyfus administration.

Owen, it is a pleasure to have you here with us today. We look forward to your testimony.

STATEMENT OF OWEN AYRES, AYRES AND ASSOCIATES, EAU CLAIRE, WIS.

Mr. AYRES. Thank you, Senator. It is a pleasure to be here.

You have asked me to comment on small business and small business problems in Wisconsin.

I would like to start out by saying that the small business designation is rather ambiguous, and even agencies within the Federal Government do not concur on exactly what it means. I would further like to add that I am against the classification of businesses into groups for the purpose of providing advantages to any particular group. This country grew into a great Nation because it was a melting pot of all people. Placing businesses into categories such as small business, large business, minority business, et cetera, benefits some at the expense of others and provides a means to manipulate the system. In the long run, it is a disadvantage to all and only encourages mediocrity instead of proven quality from the free enterprise system.

The firm I headed for many years started out as a small business enterprise, and for all practical purposes it probably still is. However, as with many firms, we were successful and had a very substantial and steady growth rate. Now normally this would sound great, but under our Federal regulations, growth is not always rewarded. Let me explain.

Our firm is a consulting engineering firm and had been working on many Federal projects for various agencies. The projects were not of any great size, but because of the number of them that we had placed under contract, the total figure was impressive. Our Federal contracts had increased greatly over the years because the quality of work was good and all projects were completed on time. When the Government decided to classify work for small business, much of the work we had been doing fell into that category. Because at about this same point in time we were reclassified as a large consulting firm, we then became ineligible for much of that work which was contributing to our growth, work that we already had under contract.

The transition from a small to large consulting classification was a horrendous experience, for much of the work we were depending on was now denied. On top of this, we were then placed with very large national and international firms to compete on large projects that we had little or no experience with.

How much better it would have been to have allowed us to slowly continue to grow into that market. We would not have had a problem had we not grown and had been content with remaining a small consulting architectural engineering firm. But because we grew and prospered, we were penalized. The system may be great for the marginal producer, but it hardly inspires others who want to progress.

I am also greatly concerned with the inequity in the return of Federal dollars to the State of Wisconsin. The percentage we receive in comparison to other States places a great penalty on our citizens. Wisconsin occupies about 2 percent of the Nation's land area and has about 2 percent of its population. We should receive about the same percentage of any Federal program.

I am very familiar with the Federal highway program, and until just recently we received less than 1.5 percent of this total program. According to U.S. News & World Report, Wisconsin is fourth from last in military spending within the State, 30th in the percentage cities receive for local budgets, and third from the bottom in total per capita Federal spending within the State.

The flow of dollars out of our State impacts all of us, but consultants and other business interests that deal directly with the Federal Government are affected even more. They not only lose business because of the inequitable distribution of funds between the States, but in many cases they find themselves competing with firms that have grown and prospered in States on the plus side of the imbalance.

One of the factors used most in the consultant selection process by the Federal Government is the location of the firm in relation to the project. When projects occur in other States, we are once again at a disadvantage. Many of our largest competitors are located in these States where large sums of Federal dollars have been spent. Federal taxes are bad enough without the unfair dollar distribution which supports our out-of-State competitors.

Wisconsin business does have some advantages and perhaps the most important of these is our people. If Wisconsin would receive a fair share of Federal revenues, we would more than hold our own in competition with other States. But it is difficult to compete with our high State taxes and an imbalance in the return of Federal taxes.

In closing, I would like to make a few suggestions.

Let all business flourish in a free competitive atmosphere. Eliminate all classifications and let the most efficient and qualified firms be the winners. In the long run, we will all be better off and we will once again dominate world business.

Fight for a more equitable distribution of Federal funds. If you give Wisconsin business a fair chance to compete, we will do the rest. With a little help, we can accomplish great things.

Senator KASTEN. Thank you very much.

As you know, I share your concern, and I think everyone in the room shares your concern, about Federal dollars coming back to Wisconsin. Under your leadership, with a little bit of help from some of us in Washington, we have made some improvements in terms of State highway dollars coming back. I thank you and you should be congratulated for your leadership. We have not won the

war yet, but I think we have made significant progress. There are a number of specific projects to which we can point when we have improved the flow of Federal dollars

I hope to continue our work with your successor Secretary Jackson, in furthering the efforts that you spearheaded.

You also may be aware that we made a little progress with HUD funds, particularly with urban development action grants in the last two rounds of UDAG allocations. We were now 13th out of the 50 States in terms of dollars coming back for UDAG. That is due to the work that a number of us have been doing, but I think we have to do more.

Clearly, we have a problem in terms of getting Federal dollars back to Wisconsin through defense contracts. We do not have the large firms here like Boeing and the General Dynamics, the kind that draw big Federal contracts, but we can get some shipbuilding and other small contracts through greater effort.

You say that you want to eliminate all small business size classifications. As you may know, the Small Business Administration has proposed some revised size standards for small businesses, so that size is determined by volume of the business as well as the number of employees.

Are you familiar with some of the new standards? What would you recommend by the criteria to define what is a small business?

Mr. AYRES. The problem is when you are doing Government work, wherever you put that level, and you hit that level, you are going from a small business to a large business. You then have much of your business shut off. What you have done when you classify businesses for governmental work, is to restrict everybody into staying where they started. It is extremely difficult to go from the small business category to a large business category. Without that designation, you can progress. And that was what we were in the process of doing.

I guess it is not very important to me for you to raise the classification for a few more months or years, for eventually if you keep expanding, you will run into a change in classification.

Senator KASTEN. This is a difficult question, but did you find people in your industry getting around those standards by deciding to diversify into three or four little companies in order to keep that designation? I am asking this because I know that this happens in other industries. I also know that some of the minority set-asides have been funneled through what are essentially fronts.

Do you see people changing their size in order to stay underneath these thresholds, to try to beat the rules?

Mr. AYRES. That is exactly what happens, but that is a lot of Mickey Mouse and you lose control of what you are trying to do. It is not very efficient at best.

Senator KASTEN. You have now seen small business from both the public and private sector perspectives. How would you characterize the delivery of small business programs through the State or through the Federal Government?

Mr. AYRES. Most highway work goes through the State government, with Federal Government backing, of course. We have to comply with Federal regulations, but the State administers the program. Other than minority business, we do not have very many

problems at that level. We do run into it with minority set asides. There again, I know of a particular minority business, run by a good friend of mine whose father is in the petrochemical business in a foreign country. He has a tremendous amount of money, and yet he operates a small business or minority business here and does an excellent job, but he has opportunities that a lot of native people in this country do not have.

Senator KASTEN. Just for purposes of discussion, after your experience in State government, do you have any specific suggestions on how we can better work together with State and Federal Government programs, to improve Wisconsin's business climate?

Mr. AYRES. Of course, my experience was mainly in the highway sector. It related to the inequities we had in Federal highway funding. There, again, we worked with people such as yourself in Washington. Now Wisconsin receives, 85 cents on every dollar we send to Washington as far as highway funds are concerned. That is a good example of the State, our State legislators, and the people in Washington working together to help that situation. It did help the Wisconsin highway program tremendously, although we still are on the short end of it.

Senator KASTEN. Do you have any comments or questions, Eddie?

Mr. HERRERA. Yes, sir, I do, Senator.

Mr. Ayres, are you aware that the size standards are being revised currently?

Mr. AYRES. Yes.

Mr. HERRERA. Have you commented on those size standards? There have been several publications.

Mr. AYRES. No, I have not.

Mr. HERRERA. They are going to be published again next month for a 60-day comment period. The area that you are talking about, the architectural engineering area, has been one of the most difficult areas for SBA in terms of size standards. It has been an area where there has been a lot of interest, not only by firms of your size but by smaller and larger firms. There has been a lot of activity in trying to raise the standards, leave the standards alone, lower the standards. It looks as though it is one of the areas where the standards are going to be raised. Let me give you just a few numbers to indicate to you why the Small Business Administration, first of all, came into effect.

Last year the Federal Government purchased $134 billion in goods and services from companies within the United States. Out of that, $44 billion went to small business, what is classified as small business. The big corporations are always fighting the size standards. They do not like small business set-asides, for obvious reasons. They are always fighting the trends of trying to get, especially the Department of Defense trying to get, the large corporations to take an umbrella contract and get everything done under their auspices. Subcontracts come to small and minority business, but mainly all of the contracts come to them.

I do not see any trend within Congress, and we are mandated by Congress, by law, to establish size standards. I do not see a trend to do away with size standards. I think they are going to be there. I think that the way for you to make sure that your input is heard is when the size standards come up for a 60-day comment period, you

definitely get in there and voice your concern and your opinion regarding those size standards.

Mr. AYRES. I have been doing that for years.

Mr. HERRERA. Are you favoring an increase in that size?

Mr. AYRES. I am just favoring elimination of size standards.

Mr. HERRERA. I realize that.

Mr. AYRES. I have heard some of the increases and they will not do us any good, and I guess I am concerned for my own firm.

Wherever you put them, you are going to get some firms or a lot of firms in the same trouble we are. If you run an architectural engineering firm, and if you are content with the size that you are and you do not want to increase it, then the size standards are great. You can get your niche and then go to work, and everything works out fine. However, if you get a little bit more ambitious than the next fellow, wherever you put those size standards, you are going to have trouble.

Senator KASTEN. Owen, thank you very much. I appreciate your testimony this morning.

The next witness is Mr. Harold Kassing, business agent for the Eau Claire Building and Construction Trades Council.

Mr. Kassing moved to Eau Claire after serving in World War II. He came to start a business. He found, instead, that he enjoyed bricklaying more, and he has been in the building trades business ever since.

He currently serves as the vice president of the Wisconsin State Conference of Bricklayers.

Mr. Kassing, welcome. We are pleased that you are participating in our hearing today. We look forward to your statement.

STATEMENT OF HAROLD KASSING, BUSINESS REPRESENTATIVE, EAU CLAIRE BUILDING TRADES COUNCIL

Mr. KASSING. Thank you.

I honestly consider this to be an honor, just to be asked to appear before you today.

With my background, you will understand that I represent labor, so I understand the feeling of minorities.

The present official unemployment rate for our area is nearly 10 percent. I feel that this is an unacceptable figure. The actual true total rate of unemployment is 20 percent. That includes the officially unemployed plus the ones that have exhausted their benefits and are not counted any longer, and the workers that have just given up looking for a job because they have been looking, in some instances, a year or a year and a half and they are no longer counted on this. The true total unemployment rate of the work force in the State of Wisconsin is nearly 20 percent.

I have checked this with the local job service, and they agree. This is a national disgrace, when we have that many people off work.

These people do count. I believe that the total amount of help that we can give a small business will have the most significant effect on the total amount of unemployment in this country.

I believe that in this day and age small businesses are the basic building block for the economy of this country. An incentive must

be directed to the small business community to encourage their confidence in the economy and, as they expand, business will hire the unemployed and reduce the high unemployment rate.

The interest rate in this country must be stabilized. We have just experienced in the last several months the devastating effect that the fluctuation in the interest rate can have on the business in this country. I realize that just saying the interest rate should be stabilized is easier by far than actually doing something about it. It is more worldwide rather than nationwide. A solution has to be found for that.

I believe that this is a priority item, the priority item, and the resources of this Nation must be mobilized to find a solution to the interest rate problem, whether it be legislating the business expansion money interest rate at a certain level and other interest rates at another level—that would be one way. That would be Federal legislation of interest rate.

I did not realize that some legislation was in progress now along this very line, but I believe that is the key to expanding small businesses and keeping the small businesses viable. Again, as small businesses expand, they will again hire the laidoff workers and bring the unemployment rate down.

If small business or business in general are encouraged and helped to stay in business and expand, workers will be needed. Wisconsin has an excellent available work force, capable of doing the job if they are hired. If our unemployed are not hired soon, many of them will wind up on welfare or other forms of relief that ultimately will be paid for by all.

The disgrace of importing all products from overseas and letting our own businesses and work force sit idle can no longer be tolerated. I am sorry if we have to step on the toes of other countries, but charity begins at home. It seems a commonsense approach is to either put a tariff or a tax or an outright ban on imports when businesses here in this country are shut down and the work force stands idle. I believe that this should be a standard policy of this country, especially when the unemployment figure is as great as it is today.

Many businesses are operating near normal and are fairly stable right now, and they are almost oblivious to the economic problems of this country. They are paying taxes and in general supporting this country. We hear that 80 percent of the people are working. We should not let the percentage give us the wrong perspective. When 20 percent of the work force in the State of Wisconsin is jobless, this is a serious problem that must be addressed.

In summary, the unemployment problem can be solved if business is helped. Business can be helped if the interest rate is stabilized and the business community has the confidence in the economy. I believe that business will hire the unemployed if we produce products here rather than importing everything from other parts of the world.

Senator KASTEN. Thank you for your testimony.

As you know, there is a growing national debate on the whole question of imports and what we are doing. This morning I spent some time touring Phoenix Steel. That firm's problem is exactly the problem that you describe. The people there are worried about

British steel imports, but they are also worried about the impact of Japanese policies as well.

One of the things we talked about as we were going through Phoenix's facilities was the fact that most of its market was in the Midwest because the transportation problems are so great and so costly. Phoenix's market is Wisconsin, Minnesota, Illinois, Iowa, et cetera.

Then we learned that a large steel contract has just been won by the Japanese. It is not a labor-intensive operation at Phoenix, so the costs of labor are not the predominant costs there. It is instead capital intensive. It is clear that at one level competing countries are, through subsidies, buying up business and therefore putting our people out of work, which has lost one shift. I was told this morning, for instance, that Phoenix Steel has already lost one shift.

I am for free trade. But I am also for fair trade. Trade must be a two-way street if it is to succeed.

We made certain agreements after World War II with the Germans and the Japanese to help improve their economies. They have now improved their economies. Therefore, I think it is time to have everyone competing on an equal basis. Our steel fabricators can beat Japanese steel fabricators and we can get the business if we remove all the subsidies. I am for tearing down the barriers. I am for penalizing those who subsidize with countervailing duties. Ideally, we would like to get rid of the subsidies, so we can compete. If we are just given a chance to compete, the American workers, the Eau Claire, Wis. workers, can compete and I believe win, but we cannot do it if the other countries are erecting trade barriers on our products and if the other countries continue to subsidize at the rate they clearly are in this particular industry. There is no way in the world that they could be getting that business anyway except by large subsidies.

I agree with much of what you say.

You said that the unemployment rate is possibly double the 9.5 percent that is being reported for this area. Are you talking about the construction industry, the building trades group, or do you think that is an overall figure covering others beyond those in the building trades?

Mr. KASSING. Now this is not just the building trades. In the building trades the rate would be higher than that, and that is quite standard. It is not standard, but it is a fact in the building trades industry today. I am not just talking building trades.

I have checked this with the job service office here. I said this at a conference that we had and there were some raised eyebrows. I checked the figures with the job service here. I checked the figures with the man that actually works with the numbers and comes up with this formula to establish the unemployment rate, and they both agreed that the rate probably is almost double the published rate. Now they have a formula to go by, and I understand that they use the formula to come up with the 9.5 or whatever the figure is, but the true rate they will quote is much, much higher than that.

Senator KASTEN. What do you, or the Building and Construction Trades Council, think would provide the incentives to bring these hidden unemployed or discouraged workers back to look for work?

We are seeing the start of a recovery. Is that enough to encourage these unemployed?

Mr. KASSING. Like I said in my statement, I believe that the key to the whole thing is getting the confidence to the small business community to get them to expand, whether it be by interest rate, tax breaks, anything that can be done to help small business. If small business goes, they will hire the people, and the natural course of events will take place. However, the key is getting the small businesses to hire people. They cannot hire people if there is no market for their business right now. The market has got to be expanded, shifted from Japan to the United States, or whatever. As small business grows, this unemployment problem will take care of itself, I believe.

Senator KASTEN. You are involved with the job-training, partnership program.

Mr. KASSING. Yes.

Senator KASTEN. Would you tell us about your experiences with the program?

Mr. KASSING. The Job Training Partnership Act has no money yet. We are just in the process of being in a setup period now. We are just continuing some of the programs that were in effect before. We really have not gotten into this type of operation.

I know that I sat on several boards before, under the old CETA program, which has been maligned from the beginning until the end. There some small businesses were helped by CETA.

The true Comprehensive Employment and Training, where they did actually take and train people, the business was helped by getting trained people, the worker was helped by being trained and getting a job. We expanded our economy that way.

I believe that little item, if carried over to enough businesses, will help our unemployment problem.

Senator KASTEN. Eddie, do you have any questions or comments?

Mr. HERRERA. No, sir.

Senator KASTEN. Harold, thank you for your participation here today. We look forward to working with you.

You talked about feeling a little bit like a minority. In some groups, as a Republican I feel a little bit like a minority myself, and I think the key is for all of us to work together. We are through the worst, I believe, but we still are in difficult straits here in the Midwest and Wisconsin. I think we are going to need the kind of help and cooperation that we are witnessing here this morning, with a lot of different groups all putting in ideas. Working together, I think, we will be successful.

Thank you for coming here this morning.

Mr. KASSING. I thank you.

Senator KASTEN. Our next witness is Mr. Tom Mihajlov, who is the director of development for the Hallbeck Group, which is an engineering firm. He is president of the Eau Claire County Economic Development Corporation, and has had extensive experience with State economic development projects.

Mr. Mihajlov is also president of the local Kiwanis Club.

I am sure, Tom, that you are going to have some good suggestions about capital formation and also business development. I would appreciate your comments on some of the ideas that have come from some of the witnesses before you as well.

I am pleased and happy to have you with us, and I look forward to your testimony.

STATEMENT OF THOMAS P. MIHAJLOV, DIRECTOR OF DEVELOPMENT, THE HALLBECK GROUP DESIGN/BUILD, INC.

Mr. MIHAJLOV. Thank you, Senator Kasten and Mr. Herrera. I appreciate this opportunity this morning, on behalf of the Eau Claire County Economic Development Corp., to share my thoughts with you.

First, let me tell you that I will not be spending my time this morning advocating lower interest rates. We all know interest rates are too high; that they need to be substantially reduced; that if they continue at their high levels they threaten the financial viability of companies large and small; and that high interest rates endanger the growing economic recovery, of which small businesses around this State are just now starting to enjoy.

Nor will I spend a great amount of time suggesting the need to continue the reduction of Federal governmental growth or the need to reduce multibillion dollar deficits. As a member of the 98th Congress, Senator Kasten, you are painfully aware of the need for fiscal restraint in Government, as this Congress, and its predecessor, more than any others during the last 25 years, have taken firm, hard, and sometimes painful steps to address this fiscal crisis. We in the small business community applaud these efforts, and we encourage you to continue to be fiscally prudent.

While we support the actions of the Congress, particularly the Senate, in reducing the growth of the Federal Government, we are somewhat confused by the bewildering array of mixed signals and forecasts coming from the economic ouija boards both in and out of Government. Consider, as an example, the events of just the last 18 months, during which the experts have told us to be patient; that if only this or that facet of the economy were improved, our financial problems would be eased. First we were told that the No. 1 enemy to economic prosperity was inflation; then it was 20 and 18 percent prime; and after that, growing budget deficits. Now the culprit is M_1, and I am certain most of us ran to our college economic texts to remember exactly what M_1 is.

During the same time the experts were telling us that these problems would have to be corrected, inflation has been reduced to a 3 to 5 percent annual rate, interest rates have dropped 6 to 8 thousand basis points—still high but becoming more manageable—and, as the economic recovery becomes more robust, the budget deficits are shrinking by $20 to $30 billion, according to latest estimates. This leaves M_1 as the only barrier to an economic Bali Ha'i, according to our experts.

Now I understand that the economic problems of our State and Nation are not quite this simple, but the point is that it is very difficult for business, particularly small business, to prepare and implement any type of sound business plan in the face of such confus-

ing and sometimes contradictory economic projections from people who should know better. These are the same experts, incidentally, who first predicted the recovery was to be very slow, then moderate and, finally, so fast that it would have to be slowed down and the apparent solution—high interest rates—doesn't give us any great comfort.

I cannot resist adding this point—in last Friday's USA Today there appeared a front page story saying that the GNP was expected to drop when revised. As you know, the GNP figures were released later that afternoon, and it was the exact opposite. It increased by five-tenths of 1 percent over the unrevised figure.

In short, we need reliable economic forecasts coming from our Nation's capital. We need to have the impression that someone, somewhere knows what they are talking about.

This has been a brief view of the economic situation as seen by one member of the small business community, but I would really like to spend the remainder of my time discussing two programs which have been of enormous help to small businesses during these rather uncertain times.

As Senator Kasten indicated, I am deeply involved in the SBA 503 program and can report to you, without hesitation, that this small Federal program has been an absolute godsend to the fixed asset needs of small businesses throughout Wisconsin and quite likely throughout the Nation. This observation is made after having witnessed the development and approval of over 60 503 loan packages. Because the 503 loan package is in three distinct parts—a 40-percent SBA guaranteed debenture made at fixed rates of interest for 15, 20, or 25 years; a 50-percent first mortgage position by a local lending institution; and a 10-percent equity injection by the business, it offers a stability in long-term asset financing previously not available to small businesses.

If the 503 program did nothing more than provide interest rate stability, it would be of great value to small business, but it does more than this. For example, the Wisconsin Business Development Finance Corporation, the statewide 503, recently reported that its 60 or so loans during the past 2 years have created or saved 973 jobs for Wisconsin residents and have provided to small businesses over $12 million in loan assistance for capital projects totaling some $33 million. Thus, the 503 program has contributed in a very real sense to the economic well-being of our State.

Like any program, 503 is not without its problems, and my purpose now is to offer some concrete suggestions as to how 503 could be improved. Not only is such testimony appropriate before this Small Business Subcommittee, it is also very timely as the Congress is currently reviewing the existing 503 authority.

As currently administered, section 503 loans are extremely cumbersom to close, requiring enormous amounts of paper and time, most of which is, in the words of one local development corporation official, "superfluous and clear baloney." It is estimated that 75 percent of the legal and professional costs involved in a 503 loan could be reduced or even eliminated if closings were simplified. In terms of time, SBA has decided to run the 503 program like a direct loan program, but the agency doesn't have the staff to administer it as a direct loan program and a bottleneck in the district

office has been created. Again, this adds costs to the small business applicant, as they must wait to lock in permanent interest rates. Section 503 loans represent a minuscule portion of the total SBA portfolio but demand a large amount of the agency's time due to the manner in which SBA chooses to administer this program.

To resolve this problem, I suggest that the lending institutions be given the same discretion to close 503 loans as they now have with the section 502 program. You will recall that 502 is a companion local development company program which has a straight guaranteed structure as opposed to using a debenture. In the 502 program the lending institution certifies that everything has been completed and closing is thus slick, clean, and less expensive. I hasten to point out that this recommendation does not require any additional staff for the SBA.

The second major problem is that the 503 corporations are unable to quote an interest rate at any time before permanent loan closing occurs. What happens if during the 8 to 10 months between loan authorization and debenture closing interest rates jump from, say, 12 to 16 percent? If the small business pro formas demonstrate that 16 percent is not a workable interest rate, is the 503 corporation then supposed to state that there is "no adverse change"? Most 503 projects involve construction and, as you may suspect, the danger to lending institutions and the small business concern can become clear and very present. Nothing strikes fear like the unknown interest rate.

To overcome this problem, I suggest SBA permit the applicant to buy a forward commitment similar to purchasing an option in the bond market. This will allow the small business concern to lock in an interest rate and the costs for such a forward commitment would be determined by how good a deal the small business wants to strike.

Typically, such an interest rate option would be in the range of one to four points. These costs in a long-term mortgage would be more than offset in a short period of time by the interest rate savings. Such a provision would also protect the bridge or interim lender who becomes involved on the assumption or commitment of a permanent takeout.

Another problem is that the 503 loan structure requires that a reserve account be established into which is escrowed 2 monthly mortgage payments. This sounds great on the surface and is meant as a protective device in the event of a loan default. However, what appears to be happening is that the reserve accounts are going to accumulate too much cash. These reserve accounts earn current money market rates of interest on which earnings the small business concern must pay income taxes. At current yields of between 8 and 10 percent, it is predicted that at about year 13 in a 20-year deal, the reserve account will accrue more cash than the principal remaining on the loan.

Clearly, this is a case of overkill, and I recommend that SBA eliminate this provision entirely or at the very least devise some method to refund the reserve account after, say, year five. Another solution may be to allow the small business concern to receive the interest payments from these accounts on a yearly basis. This

would help to justify the requirement of paying taxes on the interest earnings when they receive no real cash benefit.

These have been three ways in which the 503 program can be greatly improved. As the Congress considers the continuation of 503 authority, let me briefly summarize what those of us who have been active in the mechanics of 503 support and do not support. We strongly support the creation of a 10-year debenture. This will allow 503 corporations to finance equipment acquisitions which presently we cannot do because of the shorter useful life for this type of asset.

We do not support authority to 503 corporations to become involved in debt refinancing deals. In fact, we shutter at the very thought of the increased volume and the higher risk factors involved in such new authority. The 503 program works very well in providing financing for fixed assets and new expansions. Leave it that way. We see no real benefit in opening the floodgates for substantially higher risk loan packages. Authority for certain types of stock acquisitions does have merit, but beyond this narrow scope we feel it is folly to become deeply involved in the existing debt of small business concerns.

We encourage the Congress to fund 503 at its current level and not to intermingle those funds with those of the 502 program. The current funding level is adequate to meet the portfolio needs of existing 503 corporations. I caution, however, that if the economic recovery continues at its present pace those funds may not be adequate to meet what will be a growing need. But I am not going to sit here and tell you that the way to solve our economic ills is to increase the share of the budget that we get. If the demand increases for 503 loans, we will have to make the appropriate adjustments. And, hopefully, at the same time conventional lending sources will provide, and will become, more attractive to small business concerns.

Finally, and I address this concern particularly to Deputy Administrator Herrera, something must be done to move the paper more quickly in the SBA district office. There is no good reason why an authorization letter, most of which is boilerplate language, should take anywhere from 2 to 6 weeks after the verbal approval is given. Most interim lenders like to have the authorization letter in hand before releasing funds. If the small business 503 loan involves construction, this can produce real hardships, particularly in an area where winter construction problems can become severe. I would be remiss, however, if I did not take this opportunity to indicate to you, Mr. Herrera, that the SBA staff in the Madison, Wis., office does an admirable job, all factors considered. They are helpful, cooperative, and very diligent in their work, and I particularly applaud Finance Division Chief James A. Bren and Mr. John Mirenda, loan officer. They particularly have been helpful, and I wanted you to be aware of their efforts.

Now the rest of my remarks entails the industrial revenue bonds financing, which has been covered earlier by Mr. Hope. I submit those for the record.

I, once again, appreciate the opportunity to appear before you.

[The prepared statement of Mr. Mihajlov follows:]

STATEMENT BY
THOMAS P. MIHAJLOV, DIRECTOR OF DEVELOPMENT
THE HALLBECK GROUP DESIGN/BUILD, INC.
4520 IRONWOOD LANE, EAU CLAIRE, WI 54701
BEFORE SUBCOMMITTEE ON ENTREPRENEURSHIP &
SPECIAL PROBLEMS FACING SMALL BUSINESS
SENATE SMALL BUSINESS COMMITTEE
AUGUST 22, 1983

My name is Thomas P. Mihajlov. I am Director of Development for The Hallbeck Group Design/Build, Inc., a construction, architectural, and engineering firm with a 30-year business history in western Wisconsin. I also have the privilege of serving as President of the Eau Claire County Economic Development Corporation, a certified Small Business Administration Section "503" development company. This corporation has recently made its second "503" loan to a family owned business in a small community 20-miles south of here. In addition, I also serve on the loan committee of the Wisconsin Business Development Finance Corporation, a statewide "503" company which has made over 60 loans during the two years of its operation. Finally, for the past 10 years, I have spent the better part of my professional life working for and with small business concerns developing new approaches to their differing capital and financial needs in such areas as debt refinancings and expansions. Therefore, I feel moderately qualified to spent a few moments with you this morning discussing some of the special problems facing small business and to, hopefully, offer a suggestion or two on how the capital/financing problems of small business can be substantially reduced. I appreciate this opportunity to share my thoughts with you.

First, let me tell you that I will not be spending my time this morning advocating lower interest rates: we all know interest rates are too high, that they need to be substantially reduced, that if they continue at their high levels they threaten the financial viability of companies large

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and small, and that high interest rates endanger the growing economic recovery of which small businesses around this state are just now starting to enjoy.

Nor will I spend a great amount of time suggesting the need to continue the reduction of federal governmental growth or the need to reduce multi-billion dollar deficits. As a member of the 99th Congress Senator Kasten, you are painfully aware of the need for fiscal restraint in government as this Congress and its predecessor, more than any others during the last 25-years, have taken firm, hard and sometimes painful steps to address this fiscal crisis. We in the small business community applaud these efforts and we encourage you to continue to be fiscally prudent.

While we support the actions of the Congress, particularly the Senate, in reducing the growth of the federal government, we are somewhat confused by the bewildering array of mixed signals and forecasts coming from the economic ouija boards both in and out of government. Consider, as an example, the events of just the last 18-months during which the experts have told us to be patient; that is only this or that facet of the economy were improved, our financial problems would be eased. First we were told that the number one enemy to economic prosperity was inflation; then it was 20 and 18 percent prime, and after that, growing budget deficits. Now the culprit is M1 and I'm certain most of us ran to our college economic texts to find out precisely what M1 is.

During the same time the experts were telling us that these problems would have to be corrected, inflation has been reduced to a 3-5 percent annual rate, interest rates have dropped eight to six hundred basis points (still high but becoming more manageable), and as the economic recovery becomes more robust, the budget deficits are shrinking by $20-$30 billion

according to latest estimates. This leaves M1 as the only barrier to an economic Bali Ha'i, according to our experts.

Now I realize that the economic problems of our state and nation are not quite this simple, but the point is that it is very difficult for business, particularly small business, to prepare and implement any type of sound business plan in the face of such confusing and sometimes contradictory economic projections from people who should know better. These are the same experts, incidentally, who first predicted the recovery was to be very slow, then moderate and finally so fast that it would have to be slowed down and the apparent solution--high interest rates--doesn't give us any great comfort. In short, we need reliable economic forecasts coming from our nation's capital; we need to have the impression that someone, somewhere knows what they're talking about.

This has been a brief view of the economic situation as seen by one member of the small business community. But I would really like to spend the remainder of my time discussing two programs which have been of enormous help to small businesses during these rather uncertain times.

As I indicated earlier, I am deeply involved in the SBA "503" program and can report to you without hesitation that this small federal program as been an absolute godsend to the fixed asset needs of small businesses throughout Wisconsin and quite likely throughout the nation. This observation is made after having witnessed the development and approval of over 60 "503" loan packages. Because the "503" loan package is in three distinct parts: a 40 percent SBA guaranteed debenture made at fixed rates of interest for 15, 20 or 25 years, a 50 percent first mortgage position by a local lending institution, and a ten-percent equity injection by the business, it offers a stability in long-term asset financing previously not available to small businesses.

If the "503" program did nothing more than provide interest rate stability it would be of great value to small business. But it does more than this. For example, the Wisconsin Business Development Finance Corporation, the statewide "503," recently reported that its 60 or so loans during the past two years have created or saved 973 jobs for Wisconsin residents and have provided to small businesses over $12 million in loan assistance for capital projects totalling $33 million. Thus,the "503" program has contributed in a very real sense to the economic well-being of our state.

Like any program, "503" is not without its problems, and my purpose now is to offer some concrete suggestions as to how the "503" program could be improved. Not only is such testimony appropriate before this Small Business Subcommittee, it is also very timely as the Congress is currently reviewing the existing "503" authority.

As currently administered, Section "503" loans are extremely cumbersome to close requiring enormous amounts of paper and time, most of which is, in the words of one local development corporation official, "Superfluous and clear baloney!" It is estimated that 75 percent of the legal and professional costs involved in a "503" loan could be reduced or even eliminated if closings were simplified. In terms of time, SBA has decided to run the 503 program like a direct loan program, but the Agency doesn't have the staff to administer it as a direct loan and a bottleneck in the District Office has been created. Again this adds costs to the small business applicant as they must wait to "lock-in" permanent interest rates. Section "503" loans represent a minuscule portion of the total SBA portfolio but demand a large amount of the Agency's time due to the manner in which SBA chooses to administer this program.

To resolve the problem, I suggest that the lending institutions

be given the same discretion to close 503 loans as they now have with the Section "502" program. ("502" is a companion local development company program which has a straight guaranteed structure as opposed to using a debenture.) In the "502" program the lending institution certifies that everything has been completed and closing is thus slick, clean and less expensive. I hasten to point out that this recommendation does not require any additional staff for SBA.

The second major problem is that the "503" corporations are unable to quote an interest rate at any time before permanent loan closing occurs. What happens if during the eight to ten months between loan authorization and debenture closing interest rates jump from say 12 percent to 16 percent? If the small business pro formas demonstrate that 16 percent is not a workable interest rate, is the "503" corporation then suppose to state that there is "no adverse change?" Most "503" projects involve construction and as you may suspect the danger to lending institutions and the small business concern can become clear and very present. Nothing strikes fear like the unknown interest rate.

To overcome this problem, I suggest SBA permit the applicant to buy a forward commitment similar to purchasing an option in the bond market. This will allow the small business concern to "lock-in" an interest rate and the costs for such a forward commitment would be determined by how good a deal the small business wants to strike. Typically, such an interest rate option would be in the range of one to four points. These costs in a long-term mortgage would more than be offset in a short period of time by the interest rate savings. Such a provision would also protect the "bridge" or interim lender who becomes involved on the assumption or commitment of a permanent take-out.

Another problem is that the "503" loan structure requires a reserve account be established into which is escrowed two monthly mortgage payments. This sounds great on the surface and is meant as a protective device in the event of a loan default. However, what appears to be happening is that the reserve accounts are going to accumulate too much cash. These reserve accounts earn current money market rates of interest on which earnings the small business concern must pay income taxes. At current yields of between eight and ten percent, it is predicted that at about year 13 in a 20-year deal, the reserve account will accrue more cash than the principal remaining on the loan. Clearly this is a case of overkill and I recommend that SBA eliminate this provision entirely or at the very least devise some method to refund the reserve account after say year five. Another solution may be to allow the small business concern to receive the interest payments from these accounts on a yearly basis. This would help to justify the requirement of paying taxes on the interest earnings when they receive no real cash benefit.

These have been three ways in which the "503" program can be greatly improved. As the Congress considers the continuation of "503" authority, let me briefly summarize what those of us who have been active in the mechanics of "503" support and do not support. We strongly support the creation of a ten-year debenture. This will allow "503" corporations to finance equipment acquisitions which presently we cannot do because of the shorter useful life for this type of asset.

We do not support authority to "503" corporations to become involved in debt refinancing deals. In fact, we shutter at the very thought of the increased volume and the higher risk factors involved in such new authority. The "503" program works very well in providing financing for

fixed assets and new expansions. Leave it that way! We see no real benefit in opening the floodgates for substantially higher risk loan packages. Authority for certain types of stock acquisitions does have merit, but beyond this narrow scope we feel it is folly to become deeply involved in the existing debt of small business concerns.

We encourage the Congress to fund "503" at its current level and not to intermingle those funds with those of the "502" program. The current funding level is adequate to meet the portfolio needs of existing "503" corporations. I caution, however, that if the economic recovery continues at its present pace, those funds may not be adequate to meet what will be a growing need. But I am not going to sit here and tell you that the way to solve our economic ills is to increase the share of the budget we get. If the demand increases for "503" loans, we will have to make the appropriate adjustments. And, hopefully, at the same time conventional lending sources will provide, and will become,more attractive to small business concerns.

If the federal budget constraints allow for it, we would like to see the debenture maximum increased to $750,000. The current level is $500,000 and while adequate to meet the needs of some small businesses, capital expansion projects are becoming more costly. A $750,000 ceiling would provide loan packages which include larger projects and would be particularly beneficial to smaller, rural banks which do not have the ability, even in a first mortgage position, to fund 60 and 70 percent of the larger projects.

Finally, and I address this concern particularly to Deputy Administrator Herrera, something must be done to move the paper more quickly in the SBA district office. There is no good reason why an authorization letter, most of which is "boiler-plate" language should take anywhere from two to six weeks after the verbal approval is given. Most interim lenders like to have the authorization letter in hand before releasing funds. If the small business "503" loan involves construction, this can produce real hardships particularly in an area where winter construction problems can become severe. I would be remiss, however, if I did not take this opportunity to indicate to you, Mr. Herrera, that the SBA staff in the Madison, Wisconsin office does an admirable job, all factors considered. They are helpful, cooperative and very diligent in their work, and I particularly applaud Finance Division Chief, James A. Bren and Mr. John Mirenda, Loan Officer, they have been particularly helpful and I wanted you to be aware of their efforts.

Before I conclude,and for just a brief moment or two, I want to turn my attention to another financing tool which has helped small business and which has been somewhat emasculated by the Congress in the Tax Equity and Fiscal Responsbility Act of 1982 (TEFRA). This program is small issue industrial revenue bonds or "IRBs" for short. Since TEFRA, small business activity with industrial revenue bonds has dropped dramatically and this can be attributed in part to the recession, but also because TEFRA reduced the attractiveness of IRBs to small business and increased their issuance costs.

IRBs are exactly ten years old in Wisconsin and through 1982, a total of 876 issues were sold with an aggregate value of more than $3.5 billion. As you may know, IRBs are issued by a municipality on behalf of a business seeking to expand or build. Because the bond earnings are exempt from federal income tax, investors are willing to accept a lower interest return. Therefore, IRBs reduce the amount of interest which businesses must pay when financing a project.

Have there been abuses in the IRB program in this State and elsewhere? Sure there have been; but I tend to believe that legislators and the media focus in on the few sensational IRB abuses. For example, in May of 1981, the Wisconsin Legislative Audit Bureau released a study examining a few such abuses as golf courses, roller skating rinks and shopping centers. In fact, from 1971 thru April, 1981, the period studied by the Bureau, commercial and recreation IRBs accounted for only three percent of all Wisconsin projects. During the same time, 71 percent of Wisconsin revenue bonds were issued for "manufacturing" purposes. This data and additional data I collected while conducting a study in the Masters of Business Administration program at the University of Wisconsin-Eau Claire confirm that those who attack IRBs on the basis of commercial and recreation project abuses are concerning themselves with a very small number of issues, and consequently, a small loss to the federal treasury.

Legislators and the public must first decide whether industrial revenue bonds serve a vaild public purpose. If they agree that it is good public policy to promote the creation of jobs and encourage business opportunities, then revenue bond proponents and critics alike must also recognize that every job creating program has its costs whether publicly or privately funded. While there is no "free lunch," the costs must be weighed with future employment benefits.

The great criticism among fiscal conservatives concerning IRBs centers around the tax loss to the federal treasury. But is there a real loss to Washington coffers? A University of Chicago Business School study recently concluded that the Congressional Budget Office's revenue loss estimates are six times greater than the actual loss to the federal government. For example, if revenue bonds were eliminated and borrowers forced to pay higher interest rates, then borrowers would have increased deductions for these higher costs. Thus, the federal government would be gaining more revenue because of increased taxes on the lenders while simultaneously losing revenue because of increased deductions for borrowers's higher interest costs.

If it is not good public policy for government to stimulate private sector job creation and economic expansion, then at what cost are we willing to terminate revenue bond financing? How many fewer new jobs, how much less local expansion can we accept to prevent a federal Treasury loss? The termination of small issue IRBs would impact most severely on

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small business as bonds are used overwhelmingly by smaller companies (according to the CBO). The burden of tight monetary policies and high interest rates falls heavily on small business which can neither pay nor pass on these higher costs as easily as large corporations. Fewer jobs and less local expansion will be the result of eliminating revenue bonds as a financing tool for small and medium sized business and industry. Is this a result that we can afford?

How then do we correct the abuses which almost all agree exist in the use of revenue bonds? First, I support the Industrial Development Bond Limitation Act sponsored by Rep. J.J. Pickle. This Act would require that 1) a company which uses an IRB must use less favorable depreciation methods; 2) no company with worldwide capital expenditures of over $20-million could receive a small-issue IRB; and 3) virtually no IRB could be used to buy land. I support this bill if all of the so-called "technical" changes of TEFRA are repealed. I will itemize these in a moment.

I further support going deeper than Rep. Pickle's bill and I recommend the elimination of IRB use for any type of real estate syndicate: I do not support the feeding of tax pigs and there are enough tax advantages in the typical real estate partnership deal to resist arguments for tax-exempt interest rates.

Targeting commercial IRB financing to concerns locating in economically distressed areas is my second major recommendation. Bonds could be restricted for commercial establishments to areas of high, structural unemployment, low per capita income, or dilapidated structures. Many bond supporters urge their elimination for franchise purposes such as Hardee's or MacDonald's. It can be argued, however, that jobs created by fast food stores fulfill public purposes--jobs created by MacDonald's are better than no jobs

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at all, and often they go to poor or minority youths. These ventures may also spur additional private investment in the area. Fine, then let's target commercial IRB use to such areas.

My final major recommendation is somewhat unique to Wisconsin and that is to rewrite the statutory definition of a "blighted area." Under current Wisconsin law, a commercial IRB project must locate in a "blighted area" to use bond financing. This definition is found in three places in the statutes, at one point being some 37-lines long and so all encompassing as to border on the ridiculous. Restructuring the law to prevent bank buildings in corn fields and shopping centers in the middle of nowhere, will help reduce the criticism of commercial IRB financed projects. A rewritten "blighted area" statute could also include targeting commercial IRBs to distressed areas and small business without reducing the important availability of these bonds for industrial and manufacturing enterprises.

A few moments ago, I mentioned the need to eliminate some of the "technical changes" of TEFRA. I now outline these as follows: eliminate the need to have yet another registration for tax-exempt bonds; this is unnecessary and costly. Second, remove the cumbersome and confusing language concerning bond maturity and the weighted average of the estimated useful life of the assets financed. The bond buyer isn't going to purchase a bond with a longer term than the assets financed have useful lives. Third and most important, eliminate the provision for certain financial institutions, that the interest on the debt used to finance IRBs is deductible at a rate of only 85 cents on the dollar. This provision adds five to seven hundred basis points to the interest rate charge on IRBs. Finally, remove the strange and discriminatory provision that prevents IRB use if 25 percent or more of the bond proceeds is used to finance automobile sales or service facilities or the provision

of retail service of food or beverage. What sense does it make to pick out one or two industries in an effort to curb abuses? My earlier targeting recommendation will solve these problems.

These have been my thoughts on some of the special problems which face small business in Wisconsin and in many respects, throughout the nation. I have also tried to offer some modest proposals to improve two financing programs which have been of great aid to small businesses during these difficult economic times. Once again, I appreciate the opportunity to appear before this Senate Subcommittee, and I am now open to your questions. Thank you.

Senator KASTEN. Tom, thank you very much for your testimony. I appreciate the obvious thoughtfulness and thoroughness which you have put into this.

The Small Business Committee does have the jurisdiction for the reauthorization of 502 and 503 programs. I think there might be a place where the Finance Committee also has some cross jurisdiction.

I know you are in support of industrial revenue bonds in general. You recognize that there have been some abuses in the program with bonds used to finance golf courses, rollerskating rinks, and the like. Could you respond, though, to my question about the desirability of allowing IRB's to be used for McDonalds and similar franchises? There is a debate on this point. What position do you personally take in terms of use of industrial revenue bonds for those franchise-type operations?

Mr. MIHAJLOV. I could not agree more with your earlier comments, Senator Kasten. There have been criticisms of the use of IRB's in terms of financing franchise operations, but, as you pointed out, in many cases those franchisees are local business people who use local resources, and still in many cases those McDonalds and other types of fast food establishments locate in areas of high structural unemployment or areas where they employ young people, particularly minorities.

Now I suggest to you that jobs created by a McDonalds or a Hardees, or some other type of a fast food establishment, are better than no jobs at all. I would, however, recommend that as the Congress looks at the IRB legislation they consider targeting commercial IRB's to areas of high unemployment, low per capita income. That would cover a whole variety of criticisms that the opponents of IRB's use.

We have found here in Wisconsin, for example, that in the past 10 years 73 percent of all the IRB's issued, which are some 850 or so, have been used for manufacturing purposes; the intent that the law was originally written for; that only 3 percent could be classified as frivolous, the golf courses, the massage parlors, the rollerskating rinks, and the like.

I think that is a somewhat lengthy answer to your question. I agree with you. I support that type of concept, but I think that we have to recognize that the public policy of the Industrial Revenue Bond Act is to provide jobs and help business in their financing needs. Whether that is with a franchise operation or some other type of entity, if that is the goal, then we are going to have to accept some of the costs that go along with those goals.

Senator KASTEN. In a minute I am going to have Mr. Herrera discuss a couple of the specific points that you raised about the 502 and 503 programs. I saw him making little marks and arrows on a copy of your testimony.

I want to say that we will try to work together with you on this. All of us, particularly Jim Sanders, Mr. Herrera, and others, are trying to go in the same direction on this. I think that your testimony here is very helpful.

I have to say that I also share your problems with the economists in Washington. We are always kidding that what we need is a one-armed economist because they always say "on the one hand" and then "on the other hand."

We have a new Director of the Congressional Budget Office, and I think that Rudy Penner will do a good job. We had some problems from time to time with CBO estimates under the previous Budget Director although Alice Rivlin did her best as well.

I have been frustrated by the repeated estimates and re-estimates of economic activity, not just as a member of the Small Business Committee, but also as a member of the Budget Committee, because we try to work with deficit projections 2 and 3 years out, and sometimes they are simply not right.

Although I might be disappointed with the recent re-estimates that you are talking about, I was pleased that they were estimates in the right direction. In fact, the recovery is now appearing more robust than had been initially thought, so the new figures are actually a blessing for us all.

I know that you have been working with the Small Business Administration, so can you give me an evaluation of the effectiveness of the Small Business Administration, either at the local or regional levels, in working with and taking advice and guidance from the small businesses that it works with? In other words, are you able, to identify specific problems and get them resolved or does it seem like the bureaucracy is just too cumbersome and there is just no hope?

Mr. MIHAJLOV. I think the Small Business Administration, particularly in Madison—and I am not saying this because we may have one or two projects before them at the present time—does its best, it really does, in terms of working with both myself and our executive director, Steve Vego, who is sitting just to my left, in coming to grips with the very real problems of putting all this paper together.

I think we have to remember, Senator, that the professionals in SBA in Madison did not write the regulations. They are simply trying to enforce them to the best of their ability. There are some very, very superfluous regulations written.

We should not, for example, in a 503 package where you may be financing fixed assets with 503 authority and equipment with 7(a)

guarantee authority, have to submit two sets of the same identical forms, simply because they are two different loan programs. They are reviwed basically by the same people in the district office. One application should suffice for SBA purposes.

Second, as I indicated to you, because of the manner in which SBA has chosen to administer the 503 program, it is a quasi-direct loan program. They simply do not have the staff to come to grips with the requirements of the direct loan program.

Let the bank take care of that. SBA has a certified lender program. Many of the banks locally are members of that program and participate in it. If they have that much faith in the ability of the banks to make the loans for the guaranteed programs, allow the banks to prepare all the documentation and the requirements for the 503 program as well. This would save an enormous amount of time. It would save a lot of money to the small business concerned because that debenture is sold at the tail end. If there is one little thing out of scope in closing, it delays the sale of that debenture for a month, and the small business is required to pay interim costs until that debenture is wrapped up.

We have found that, in fact, the loan officer—I quoted Mr. John Mirenda—asked for my suggestion in my profession with our firm, as to how best they could get a signoff to indicate that the buildings that they are financing have been completed according to plans and specifications, because building codes from town to town to town to State in Wisconsin differ somewhat. They wanted one uniform type of statement that would tell them that the building is good collateral essentially. I was happy to respond to that.

I think that the Small Business Administration, more than any other Federal agency, it has been my experience, interplays with small business people and local people to try to find the best way to administer their program.

Senator KASTEN. Eddie, we are obviously not going to solve all these questions and problems right now, but I would be interested in some of the comments you might have in response to some of Mr. Mihajlov's specifics.

I want to assure both of you that, as a member of the Small Business Committee, with the responsibility for working on the reauthorization legislation, I think an awful lot of what Tom is saying makes sense. In this next reauthorization cycle, by working with you and Jim Sanders, maybe we can make a little bit of difference on these programs.

Mr. HERRERA. Certainly, Senator.

Tom, I want to really thank you for such a professional job. I think you have done some work here in analyzing and making recommendations that has saved us a lot of time in the Small Business Administration. I like your recommendations. I like them from the standpoint of a former State government executive. I think all of the ideas you have proposed here are certainly what I would want to see when I get back to the private sector, and I have an opportunity to work with programs like this. I would like to see the same type of recommendations that you have just indicated implemented.

As I mentioned to you earlier today, this is a program that I have direct control over. It is also one of the most exciting pro-

grams that we have. There is a lot of interest in Congress on this particular program. It is showing tremendous growth. There are over 400 certified development companies in the United States, and it is continuing to grow. We are funding about $250 million, and that looks like it will continue at that rate. There is tremendous interest in it. It is an economic development program. It is a job creation program. We are very, very excited about this, and we are putting a lot of resources into the area.

I cannot help but mention to you that it is a program that I have direct responsibility over, and I am going to take your suggestions to our associate administrator for the national program and get him to analyze the suggestions in light of implementing them. I will work with Senator Kasten and keep him informed, as to what we are doing, and get him to then communicate to you and to members of your community here as to what kinds of suggestions we can implement, what we can do with the regulations, which ones we might need some legislation on. I think most of these can be done through regulations. It is just a matter of looking at it.

We do have some areas that need to be looked at very, very carefully. For example, as you well know, the banks in this program, as well as the guaranteed loan program, are very important to us. In some cases the banks do not really do the job they are supposed to do. Consequently, we wind up getting eaten up by GAO and other governmental agencies.

Therefore, we have to be very, very careful as to how we safeguard the taxpayers' money and still deliver the best service to the small business community.

You have my commitment on this. I have looked at your suggestions, and I think they are excellent suggestions.

Mr. MIHAJLOV. Thank you.

As a postscript to your very kind remarks, I would just say that this is a new program. I think one of the great things about being able to testify before this subcommittee this morning is to present to you some solutions or some suggestions from someone who has worked in the field with a new program. I couldn't agree with you more—503 is a great, great program. It is very exciting for those of us in Eau Claire. I know, with the statewide 503 corporation they are doing a job for small business that simply was not there before.

Senator KASTEN. I have no further questions.

Tom, I want to thank you very much.

I would like to thank all of our witnesses for what I think were a wonderfully helpful, high quality presentations this morning. As I said at the beginning of the hearing, I know that there are others who have comments, but time simply does not permit us to hear from everyone today. This is part of a series of hearings that we will be having, which will extend over the next year or two.

I would, therefore, like to once again ask anyone who does have specific questions or comments to submit them to this subcommittee in writing. My staff counsel, Louis Luna, will then work with those comments. They will be included as part of the permanent record of this hearing.

I would like to thank everyone again for coming.
This hearing stands adjourned.

[Whereupon, at 11:45 a.m., the subcommittee recessed, to reconvene at the call of the Chair.]

APPENDIX

LASER MACHINING, INC.,
Somerset, Wis., August 15, 1983.

Senator ROBERT W. KASTEN, Jr.,
Wausau, Wis.

DEAR SENATOR KASTEN: Thank you for the invitation to the hearing in Eau Claire on Monday, August 22. We will be unable to send a representative but wish to submit the following comments:

The health of the economy is vital to all business but especially to small business with its small margin of reserves. We feel interest rates must be kept down but of utmost importance is to substantially reduce the national debt. Its size appears to be threatening the very life of the economy.

To encourage expansion and product development we would urge the Congress to keep industrial development bonds tax free and to also fully fund the Small Business Administration direct and guaranteed loans. We have benefited from various SBA programs and have recently moved into a much needed new building made possible with an SBA guaranteed loan. We have recently discovered CETA assistance in helping offset the cost of training new employees. This helps us since we cannot find employees in this area already trained in machining with lasers. We would also urge Congress to fully fund programs aimed to assist small businesses, such as SCORE [Service Corps of Retired Executives] and the Vocational Development Center at the University of Wisconsin-Stout.

Please continue sending us notice of hearings in our area that would be of interest to our business.

Yours truly,

RITA LAWSON,
Vice President.

BAUMGARTNER CHEESE STORE, INC.,
Monroe, Wis., August 19, 1983.

Senator BOB KASTEN.

SENATOR: Union labor abuse is so prevelant in this country that everything that can be done to counteract it should be accomplished.

It should be obvious to everyone that practically all the large basic industries in this nation, steel, automobiles, etc., that at the bottom of business activity are also the bastion of very strong unions. That unions have badly hindered economic recovery in this country with their excessive wage demands is very evident.

To aid this cause the Bacon-Davis law should be revoked immediately. This law has cost the communities in this nation millions of excessive wage payments.

Also unemployment benefits and food stamp programs should be completely eliminated or cut back drastically. All these programs do is encourage people to try and get jobs.

Sincerely,

BOB HAHLEN,
President.

AUGUST 19, 1983.

MR. KASTEN: I'd like to submit some testimony that pertains to my business, which is, heavy machine operator. I own and operate a Crawler Tractor, and have operated one for 11 years. I'd like to say that the farmers need more state and county funding for me to stay in business. In Buffalo County alone, of all the farm-

ers that sign up for help, only about ⅓ receive it. The majority of work I do pertains to Pollution Control and Soil Conservation. Also, from my point of view, some (not all), of the cost sharing approved for farmers are not as major as some that are denied. Could it be that there should be someone else from elsewhere to take a look at some of these jobs to be done to receive another appraisal? You see if farmers don't receive funding, then that makes me somewhat short of work too. It also leaves the farmer with his land in need of repair for the future farmer.

Would also like to see more funding for smaller contractors such as I. There seems to be more funding for larger firms, with more equipment than I have. After all, we can't all be big. Give the little guy a bigger break.

Now the Government is taking a dollar away from the farmers on their milk. This is by no means going to help my line of work. You see there are farmers that do their own private work to benefit themselves, by calling upon people like me for services to be performed. With that extra dollar gone it's to hurt me just as much, if not more. This will make them more dependant on state and county funding. This route will take longer than it was something they could have paid for out of their own pockets for benefiting their farmland.

Another point I'd like to make is about the S.B.A. Loan. I had originally wrote to you about some help in obtaining information on just such a loan. I'd like to thank you at this time for sending information. Right now, we have just finished filling the paper work out involved in this matter. I'm sure you know about the projection sheet that needed filling out. It's rather difficult to project, when, like I said before, the Government and what it does for the next 3 years will affect my work, and everyone else in this type of employment.

From what I know of the S.B.A. Loan it is a plus for Small Business. It is just what we could benefit by for sure.

Would like to thank you at this time for listening to me.

Mr. and Mrs. MERLE KENT.

SCHWANDT IMPLEMENT CO., INC.,
Shiocton, Wis., August 22, 1983.

Senator BOB KASTEN,
Wausau, Wis.

DEAR SENATOR KASTEN: This letter is in regard to your letter about "Special Problems Facing Small Business in the Midwest". We would like to express our opinion on the subject. Our views will be strictly concerning small business in the agricultural communities.

We are located in the village of Shiocton and are a small business. We have been here since 1923. In the past several years, business has hit an all time low. Between the extreme amount of inflation, taxes, and hikes of interest rates, there is little cash flow to work with. Then to complicate matters, we are faced with the possibility of our customers, the farmers, losing $.50 extra per 100# of milk. Then the government produces an idea such as the PIK program. PIK has almost destroyed the agricultural business. Never have we seen a program do this amount of damage. Not only are we unable to sell our combines and bigger tractors because of it, it has also hurt several of our customers. The custom combiner will be losing several thousand dollars, and the price of corn will now elevate to heights where the farmers will be unable to afford feed for their livestocks offspring, causing meat prices to rise. All this without warning to any of us.

Because of all the problems now facing the American Farmer, we cannot blame them for being afraid to consider taking a step forward in the purchase of new or used equipment. Because of this uncertainty, we, the dealer, are also unable to help the economy by purchasing equipment from our suppliers for our lots. When we don't take the chance, several thousand people will be put out of work. Having had the chance to speak to other dealers, we find that it is not just us experiencing these hard times. We have also spoke with the SBA and found that agricultural dealers, who are presently working with SBA loans, are working their books in the red.

For the first time in over 20 years, our business is going to have to put a mortgage on our premises, just to say alive. In the past 3 years, our bank loan has more than quadrupled. This has not been for improvement reasons, but just to stay in business. We felt that any dealer that could hold its own in these times, would in the long run come out ahead. We now realize that this was just a dream, and perhaps we should have gotten out while we were able to. For us, the American Dream has become the American Nightmare.

Although this company feels that you personally have done great service to the small business, we want you to know that, in general, we feel that when the government stepped in to "help" out, they put us in a spot that we won't be able to get out from under. The whole matter has become completely frustrating, extremely costly, and unfortunately, poorly handled. There is no going back at this time, and we really can't see where many will be able to go forward for much longer.

We appreciate your concern on this matter, and also appreciate the chance to express our views. We hope they will be taken into consideration before new programs are put into effect.

Cordially,

VIRGIL SCHWANDT,
President.

MARLYN SCHWANDT,
Vice President.

HEDLUND EQUIPMENT SALES, INC.,
Boyceville, Wis., August 15, 1983.

Senator BOB KASTEN,
Wausau, Wis.

DEAR MR. KASTEN: Some of the special problems facing my small business are:

Bad checks and the collection of them.

The bankruptcy laws which bail out credit customers.

High interest rates affecting both the cost of doing business and the amount of business being done.

The high cost of liability and medical insurance coverage, which have doubled over the past 4 (four) years.

Sincerely,

VAUGHN HEDLUND.

BUTLER MANUFACTURING CO.,
Fort Atkinson, Wis., August 5, 1983.

Senator ROBERT W. KASTEN,
Wausau, Wis.

DEAR SENATOR KASTEN: Sorry we will not be able to attend the Eau Claire meeting as we will be in Washington, D.C. for the week. However, our business is concerned with two important pieces of legislation and would very much appreciate your support.

Our company is associated with the livestock sector of agriculture and serves the dairy market in particular. We've recently expanded our operation in Wisconsin but serve the agricultural sector nation wide.

Of particular interest is the resolution of the Dairy Bill. We like most dairymen see a need to stabilize an industry that over the past two years has operated with extreme uncertainty. As a result, buying habits have been reduced and our employment has been reduced substantially. The present Dairy Bill although a compromise will reduce the concern of dairymen on what the future holds.

Also of concern is product liability from a standpoint of a national attitude of "sue first and see what you can get." We would strongly support S. 44 as a means of addressing the issue.

Thanks for your interest and we hope these two issues get resolved after the August break.

Sincerely,

LARRY D. HAYES,
President, Butler Livestock Systems.

DAN AND JOHN'S AUTO REPAIR,
New Lisbon, Wis., August 15, 1983.

Senator BOB KASTEN,
Wausau, Wis.

DEAR MR. SENATOR: I am unable to attend the hearing on "Special Problem Facing Small Business" but I'd like to take a moment of your time to address my comments.

Whatever happened to "The Paper Reduction Act"? My husband and I have been in business for 13 yrs. In May 1983 we reopened a service station that we had previ-

ously sold in 1981. Mr. Senator I have been swamped with government forms, regulations etc. etc.

Since we are a small business, we cannot afford fulltime book keeping, accountant services. With 5 children, I cannot spend 60 hrs a week doing paperwork—most of which is for the government.

Let me explain what has happened since reopening our service station.

No. 1—I called the I.R.S. to re-establish our Fed. Emp. I.D. number since we had previously been in business, I thought it would be a simple matter. Not so, the gal at I.R.S. said they'd send me a form to fill out (which would take about 2 wks to receive, she said). After they received the form it would take about a month to process. Fine. Finally after about 6 wks, I received verification that our previous Fed. Emp. I.D. number had ben re-established. Then, I waited & waited for my Federal 501 with holding cards to arrive.

After making another call to the IRS, I learned that I was supposed to order the cards. Now Sir. it seems to me that the IRS knows what forms employers need and should send out all pertinent information when Fed EID numbers are established.

No. 2—I feel an area that could be revised to redeem paperwork for not only employers but also for the government would be unemployment comp. Why have State and Federal comp forms? Why not increase the amount of withholding for State unemployment comp-extend the number of benefit weeks and eliminate the federal U.C.? The State is already employing people to handle the forms—why duplicate the services on the federal level? I'm sure a lot of federal employees and paperwork could be eliminated if U. C. was handled solely by the States.

No. 3—Not only did I have to apply for the Fed EID, best also for the State EID; I had to get a State sales tax permit and open up a State unemp. comp. account. The State is not satisfied with one sales tax permit. Since we do pump gas. I recently learned that we have to have a separate permit for deisel fuel—which means that I have to keep additional records on the amount of deisel fuel we purchase and send in the tax on that. When we purchase reg. & unleaded gas from our supplier, the tax is figured into that amount—not so on deisel fuel I'm told. Why not? I ask. Why can't the tax be figured in by our supplier—or by his supplier? Why should I have to get another permit and have to keep more records?

No. 4—When I applied for and received my state Emp ID, I feel I should have received all pertinent information concerning employees, wages, hours, etc. I did not. Again, an employer has to send for such information. I just learned that my own teenagers need work permits to work at our station. Ridiculous.

In closing, I want to say, I feel very sorry for someone just starting a business for the first time. They have no idea what forms they need, who to call, etc. I at least am slightly familiar with some of the forms. But government forms and regulations change constantly. Through some simple over sight, a person in business can find himself in violation of some regulation. Everytime you politicians pass another law, another regulation, you take away more of our freedoms. We are becoming more and more communist socialist. I dont mind sending in State sales tax, State, Federal and Soc. Sec. withholding. I do mind the constant barrage of regulations and paperwork flooding my desk. Back off! Let Businesses tend to Business. The government does not pay me to do all this paperwork for them. I am providing a service for the government. The less paperwork I have to do for the government, the more time I can spend tending to business, the more profits we'll make—the more money the government will collect in taxes.

Thank you.

Sincerely,

KATHLEEN NICHOLSON.

STATEMENT OF KEITH MURIE, ON BEHALF OF MIDTEC PAPER CORP., KIMBERLY, WIS.

Midtec is a manufacturer of coated printing papers. While we do not fit the SBA's small business guidelines for our industry group, we are a small business by paper industry standards, particularly when one considers the capital intensive nature of the industry.

Midtec was formed in 1976 for the purpose of acquiring the Kimberly Clark mill in Kimberly. This mill had been the main employer in the town since 1904, but Kimberly Clark had announced that the mill would be shut down unless a buyer was found.

A number of companies looked at the mill, including some of the major paper companies, but the group of individuals who formed Midtec were the only ones who made a firm offer. The major shareholder was, and is, Mr. George S. Petty.

Since acquiring the mill in 1976, Midtec has spent over $155 million on expansion and modernization projects and has put in over $30 million in working capital. Capacity has grown to 800 tons per day from 400 and employment has gone from 700 to 1,200. In short, we have taken a mill that was about to be closed and turned it into a relatively modern, competitive facility.

To ensure our viability for the long term, however, we need to spend an even larger amount to replace the older paper machines we acquired. These date back to 1912 and are becoming less competitive each year. In this way, we are similar to many capital intensive industries in the Midwest. Years of limited reinvestment, in our case by the previous owner, have created the need for huge investments for modernization to allow us to remain competitive.

What is different in our case, is that we are a small business and our infrastructure is in the Midwest. Any expansion we make will be here, unlike the larger paper companies who are tending to relocate to the South rather than reinvesting in the Midwest. This is not universally so, but there is certainly a trend in that direction.

The foregoing gives you some background. The next topic is how Congress can help us. We believe there are two ways.

The first is to review the size limitations of capital intensive industries for SBA purposes. If that is impractical, then perhaps a separate but similar program could be set up for companies that are relatively large, but highly capital intensive and small compared to most other companies in their industry. Many of these companies are located in the Midwest and need capital to expend and modernize, but do not have the same access to the capital markets as their larger competitors. These smaller companies are more likely to modernize and expand here rather than expand elsewhere and let their Midwest facilities deteriorate.

The second way you can help is to encorage the passage of the "Work Opportunities and Renewed Competition Act of 1983", S1593, S1594 and HR3434. This act will allow companies like Midtec to utilize the Investment Tax Credits they have earned for further expanision.

Again, the comparison with large companies must be made. Having a number of locations, they have been able to offset the credits earned in one location with the earnings from other, more mature facilities. Failing that, they were able to sell the credits under the "Safe Harbor" leasing provisions.

Neither of these alternatives are available to small, single location companies like Midtec. The result is a situation where large companies are given a significant advantage over smaller ones, and the tax incentives Congress has authorized to encourage American industry to modernize and expand are not available to companies that would dearly love to use them in order to do just that.

ACORN EQUIPMENT CORP.,
Stevens Point, Wis., August 23, 1983.

Senator ROBERT W. KASTEN, Jr.,
Senate Office Building,
Washington, D.C.

DEAR SENATOR KASTEN: Please include the following statement for the record of your recent hearing of the U.S. Senate Subcommittee on Entrepreneurship and Special Problems Facing Small Business:

Welfarism threatens to destroy our Republic and a good example is the dairy price support program which is nothing more than welfare for some dairy farmers. In the long run the dairy industry would be best served by eliminating this welfare. Even though this would hurt our company for a brief period we are willing to accept it. However, all other welfare waste must also be eliminated since welfare merely diverts valuable resources away from creative, productive uses. And the saddest fact of all is that all this welfare has not really benefited anyone.

Our welfare society reflects a Republic which is in its period of decline because it has become controlled by a multitude of special interest groups all looking for a piece of the welfare action. Our country lacks vision; it does not have a sense of where it wants to go and this downhill trend can be linked directly to the rise of special interest groups.

In a very real sense we are providing bread and circuses to the masses while our government fiddles as Rome burns.

Sincerely,

JAMES T. BENZMILLER,
President.

REX SYSTEMS, INC.,
Chippewa Falls, Wis., August 22, 1983.

U.S. SENATE,
SMALL BUSINESS SUBCOMMITTEE,
Washington, D.C.

Ref: Field Hearings, Eau Claire, Wis.

GENTLEMEN: Rex Systems Incorporated is a ten-year-old small business engaged in manufacturing electronic subassemblies on a contract basis with various defense procurement facilities. We employ thirteen (13) persons, with annual sales of $1.5 million. Our company offers the Government second source capabilities on electronic items of which they have had the foresight to purchase complete engineering data packages (drawings) when purchasing the original system.

Our attendance today is to emphasize the economic importance of the Government's purchasing complete engineering data packages when possible, with the original purchase of any defense electronic equipment. This action will allow the subsequent breakout of spares support of these systems on a competitive basis, since the Government will own the rights of said supporting engineering documentation.

Our first major problem has involved obtained engineering drawings associated with Government procurements of which the Government owns the data rights but has used every means possible to restrict or deny the dissemination thereof.

This problem is being effectively addressed through the recently organized National Small Business Government Contractors Association (NSBGCA). They have been actively gathering information with which we can fight these problems at the various Government procurement activities we deal with.

Our last major problem involved the obtaining of a repair contract through a "basic ordering agreement" on a particular system that has been held exclusively by the original prime contractor for the past ten (10) years, plus.

We would like to feel that "some" headway is being made in this area, but when measured over the seven (7) year effort, progress is certainly at a snails pace!

In conclusion, we feel that an occasional assist from the offices of the Small Business Administration could be a valuable tool for us, however to date help has been practically nonexistent.

We feel also that if input by the National Small Business Government Contractors Association is considered on future and pending DOD procurement regulations and actions, it will be mutually beneficial to our country and the small business community.

Sincerely,

G. REX RATHBUN, *President.*

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